Chapter Three

The Evolution of U.S. Laws: An Economic Perspective

The net economic welfare of the United States would clearly be promoted by treating the pricing practices of foreign producers in the United States similarly to the way the antitrust laws treat the pricing practices of domestic firms. In other words, if the United States prohibited predatory pricing but allowed most nonpredatory price discrimination and selling below cost to go unfettered, the U.S. economy would benefit. That was approximately U.S. policy early in this century. Antidumping law was a reasonably close approximation to a prohibition on predatory pricing to complement the Sherman Act, which made such pricing by domestic firms illegal.

Over the years, however, antitrust law and antidumping law have taken strikingly divergent paths. At least in recent decades, the courts have tightened requirements for proving predatory pricing under the antitrust laws. Their actions reflect economic research indicating that such behavior is infrequent and seldom rational. They have also interpreted the antitrust laws to prohibit mainly the small subset of cases in which price discrimination is predatory. Harm to the economy can be demonstrated reliably mainly for cases in this subset, whereas vigorous prosecution of cases that do not represent predatory price discrimination could diminish the beneficial effects of competition.

Antidumping law has long been moving in the opposite direction. The definition of dumping has been expanded to include most selling below cost, as well as price discrimination in which a lower price is charged in the U.S. market than in the exporter's home market. The law provides for duties on any dumped imports that injure U.S. firms. Seldom does dumping by the current definition have anything to do with predatory pricing, and antidumping duties are not restricted in any way to cases of predatory pricing.

Thus, the pricing behavior of foreign firms, which at one time was treated similarly to that of U.S. firms, is now treated much differently. The emphasis of the law relating to pricing by U.S. firms (antitrust law) is on maximizing consumer welfare and the efficiency and productivity of the economy by preserving competition. Aside from ensuring the survival of enough firms to maintain competition, little or no concern is shown for firms suffering from competitors' low prices. Yet the emphasis of the law relating to pricing by foreign firms (antidumping law) is on protecting domestic industry by diminishing competition--the competition from foreign firms. Antidumping law provides protection regardless--and usually to the detriment--of the consumer and the efficiency and productivity of the economy as a whole.

As is the case with dumping, a foreign country could use subsidies to aid the predatory pricing of its firms' products in the United States. Unlike antidumping law, however, U.S. countervailing-duty law has never attempted to distinguish cases of possible predatory behavior from the much more numerous nonpredatory cases. Currently, the law serves to protect particular domestic industries without regard for the effects on consumers or the trade, efficiency, and productivity of the rest of the economy.

Countervailing-duty law serves other functions, however, besides protection. Although the net effect of foreign subsidies on the U.S. economy is generally beneficial, the subsidies generate pressures for the U.S. government to respond with countersubsidies. U.S. countervailing-duty law acts as a disincentive to foreign governments to subsidize their industries. Further, when it fails to deter subsidization, it alleviates pressure on the U.S. government to respond with countersubsidies. Several reasons account for that effect. Although countersubsidies are less damaging to the economy than are countervailing duties, countersubsidies increase the government's budget problems whereas countervailing duties alleviate them. Further, countersubsidies carry the risk of escalating rounds of tit-for-tat retaliatory subsidies by the United States and other countries.

Antitrust Law

In the last quarter of the 18th century, the spread of the industrial revolution from Britain to Europe, the United States, Russia, and Japan brought with it the development of large industrial concerns with substantial market power.[1] In some cases, that power was enhanced by the formation of trusts, cartels, and other monopolies. Such market power was subject, or thought to be subject, to various abuses, among which were high prices and predatory pricing.

The Sherman Act

In the United States, concerns about monopoly abuses resulted in the passage of a series of antitrust laws. The first such law was the Sherman Act, passed in 1890.[2]

The Sherman Act prohibited "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations."[3] It also made it illegal to "monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations."[4] Violations of those provisions were misdemeanors punishable by fines, imprisonment, or both. U.S. attorneys could obtain injunctions to prevent or restrain violations. Furthermore, private parties injured by violations could bring suit against the perpetrators and recover treble damages.[5]

The courts have long interpreted the Sherman Act to prohibit predatory pricing. Without a showing of predatory intent, price discrimination and selling below cost are not held to be violations of the law.[6]

In the past two decades, the courts and the Federal Trade Commission have become more skeptical of claims of predatory pricing than they were previously. They tend to look for evidence of such factors as prices below average variable cost (not merely below average total cost), large enough market share and sufficient barriers to other firms' entering the market to make monopoly and subsequent price increases feasible, and local price cutting in particular markets rather than general price cutting in all markets.[7] Mere price discrimination or selling below average total cost are not generally sufficient for demonstrating predatory pricing.

The Federal Trade Commission Act and the Clayton Act

Dissatisfaction with the courts' interpretation of the Sherman Act led to the passage in 1914 of the Federal

1. This section is based on discussions contained in F.M. Scherer and David Ross, *Industrial Market Structure and Economic Performance*, 3rd ed. (Boston: Houghton Mifflin Company, 1990), pp. 449-472 and 508-516; George C. Thompson and Gerald P. Brady, *Text, Cases and Materials on Antitrust Fundamentals*, 3rd ed. (St. Paul, Minn.: West Publishing Company, 1979), pp. 11-16; Jacob Viner, *Dumping: A Problem in International Trade* (Chicago: University of Chicago Press, 1923), p. 239; and the laws in question.

2. 15 U.S.C. 1, 26 Stat. 209.

3. Ibid.

4. 15 U.S.C. 2, 26 Stat. 209.

5. 26 Stat. 209, Sec. 1, 2, and 7.

6. See Scherer and Ross, *Industrial Market Structure and Economic Performance*, pp. 449-472 for a discussion of the history of predatory pricing and other related jurisprudence under the Sherman Act, and pp. 508-516 for a discussion of antitrust policies toward price discrimination.

7. Not all economists are satisfied that the courts have kept completely up to date with the economics literature on predatory pricing. See Alvin K. Klevorick, "The Current State of the Law and Economics of Predatory Pricing," *American Economic Association Papers and Proceedings* (May 1993), pp. 162-167.

Trade Commission Act and the Clayton Act.[8] The Federal Trade Commission Act created the Federal Trade Commission (FTC), which the act empowered to proceed against "unfair methods of competition" in interstate or foreign commerce.[9] The general and undefined nature of the latter power resulted from the view that businesses would always find new ways of suppressing competition that did not violate any given list of prohibited behaviors. The act empowered the FTC to proceed against each new form of unfair behavior as it appears and is recognized as a problem.

FTC proceedings are administrative and prospective (that is, the FTC can proscribe future behavior, but cannot punish past behavior). When the FTC believes a firm is engaging in unfair competition, it issues a complaint that is heard before an administrative law judge. If the judge agrees there is a violation, he or she issues an order for the firm to cease and desist. That order can be appealed to the courts. Assuming the order either is not appealed or is upheld on appeal, the firm is subject to fines if it continues the behavior. On judicial review, a decree to obey the order can be issued, in which case violations make the firm liable to be held in contempt of court.

Section 2 of the Clayton Act was the first law to restrict price discrimination outside the railroad industry.[10] It prohibited charging different prices to different customers when: (1) the price difference did not reflect differences in cost, grade, quality, or quantity; (2) it was not a good faith effort to meet competitive pressures; and (3) "the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly."[11]

The Clayton Act authorized the Federal Trade Commission to enforce the act's provisions through the sort of administrative and prospective proceedings described above.[12] It authorized U.S. attorneys to obtain civil injunctions to prevent and restrain violations of the act, and it gave private parties the right to obtain injunctions to protect them from violations of the antitrust laws generally.[13] It also gave parties injured by violations of the antitrust laws the right to sue for treble damages.[14] Finally, it made individual directors, officers, or agents of corporations violating penal provisions of the antitrust laws guilty of misdemeanor violations, if they directed, ordered, or carried out the corporate violation.[15] In addition, it subjected them to punishment by fines and imprisonment.

The Robinson-Patman Act

In the 1920s and 1930s, the large chain retail stores rose to prominence. The market power of some of these chains enabled them to negotiate lower prices from manufacturers than the traditional small independent retailers could obtain. For that and other reasons, the small retailers found it difficult to compete, leading to pressure for the Congress to do something to help them. That pressure and dissatisfaction with the success of the Clayton Act in preventing price discrimination led to passage in 1936 of the Robinson-Patman Act.[16]

The Robinson-Patman Act amended the Clayton Act to make it unlawful "to discriminate in price between different purchasers of commodities of like grade and quality" where the effect "may be substantially to lessen competition or tend to create a monopoly in any line of commerce, *or to injure, destroy, or prevent competition* [emphasis added] with any person who either grants or knowingly receives the benefit of such

8. The Federal Trade Commission Act is 15 U.S.C. 41, 38 Stat. 717; the Clayton Act is 15 U.S.C. 12, 38 Stat. 730.

9. 15 U.S.C. 45, 38 Stat. 719.

10. Scherer and Ross report that "[t]he Interstate Commerce Act of 1887 prohibited 'undue' discrimination in railroad rates, with special bars against personal discrimination and rates that were lower on the same line for longer than shorter hauls 'under substantially similar circumstances and conditions.'" See Scherer and Ross, *Industrial Market Structure and Economic Performance*, pp. 508-509.

11. 15 U.S.C. 13(a), 38 Stat. 730.

12. 15 U.S.C. 21, 38 Stat. 734. An exception was made for common carriers, for which enforcement authority was placed in the Interstate Commerce Commission. Exceptions were also made for banks, banking associations, and trusts, for which enforcement authority was placed in the Federal Reserve Board.

13. 15 U.S.C. 25, 26; 38 Stat. 736, 737.

14. 15 U.S.C. 15(a), 38 Stat. 731.

15. 15 U.S.C. 24, 38 Stat. 736.

16. 15 U.S.C. 13, 21a; 49 Stat. 1526, 1527. See Scherer and Ross, *Industrial Market Structure and Economic Performance*, p. 509.

discrimination, or with customers of either of them."[17] Exceptions were made for price differences resulting from differences in cost, charging low prices to meet those of a competitor, disposing of deteriorating perishable goods or obsolete goods, and disposing of goods in a closeout or bankruptcy sale. The act also prohibited buyers from knowingly inducing or receiving a prohibited discrimination in price. The act made some violations criminal offenses punishable by fines and imprisonment.

A key issue relates to the phrase emphasized above: "or to injure, destroy, or prevent competition." Does "competition" refer to competitors of the firm engaging in price discrimination or to the vigor of competition between and among the price-discriminating firm and its competitors? The former could make almost all price discrimination illegal, depending on the standard of injury. The latter is a much more demanding standard. If the price-discriminating firm takes away 10 percent of the market share of each of its competitors but does not drive any of them out of the market, each competitor is injured. Yet the loss does not affect the vigor of competition between and among the competitors and the price-discriminating firm.

The courts have decided this question differently depending on the relation of the injured firms to the participants in the low-price sale.[18] The injured firms might be competitors of the price-discriminating firm, competitors of the firm receiving the lower price, or competitors of the customers of the firm receiving the lower price. Injury to the first of these groups--competitors of the price-discriminating firm--is the sort of injury that is at issue in predatory pricing and dumping cases. In cases of such injury, the courts have generally interpreted "injury to competition" to mean "injury to the vigor of competition." Over the years, the standards for proving such injury have evolved to the point that they are now essentially identical with those for predatory pricing cases under the Sherman Act. Thus, the sort of price discrimination that is the domestic analog to dumping is illegal only in cases of predatory pricing.

17. 15 U.S.C. 13(a), 49 Stat. 1526.

18. Scherer and Ross, *Industrial Market Structure and Economic Performance*, pp. 512-513.

The History of Antidumping Law Through World War II

Concern about abuses of monopoly power did not remain restricted to the domestic front. The same abuses could occur in international trade, where they sometimes caused even more concern because they carried collateral implications for national security. The main abuse that is of interest for this study is predatory pricing. Then, as now, international predatory pricing was often lumped together with, and not distinguished from, international price discrimination that charged lower prices on exports than on the same goods sold in the home market. Both were referred to as dumping.

Early on, most dumping was by British firms, since they led the industrial revolution and were therefore the main monopolies in existence. U.S. and German firms became the world's major dumpers in the late 1800s and early 1900s. In the United States, high tariffs protected domestic firms from import competition, allowing them to charge high domestic prices that they could not maintain on their exports abroad where they had competition. In Germany, the firms in various industries joined together into cartels to maintain high domestic prices that they could not maintain on their exports.

Only New Zealand, Australia, Canada, and South Africa passed any antidumping legislation before 1914, which suggests that most countries did not consider dumping to be a problem.[19] Nevertheless, domestic producers pressed for such laws in the United States and other countries. Such laws provided an opportune vehicle for obtaining protection for two reasons. First, with many (if not most) firms having greater market share and monopoly power in their home markets than abroad, they would predictably charge higher prices at home than abroad--that is, much of international trade would be dumped. Second, the possibility of predatory pricing allowed the producers seeking protection to gain support among consumers, whose interests are normally harmed by protection more than producers' interests are benefited.

19. William A. Wares, *The Theory of Dumping and American Commercial Policy* (Lexington, Mass: Lexington Books, D.C. Heath, 1977), pp. 13-14.

The Sherman Act

In the United States, the Sherman Act might be expected to prohibit predatory dumping by foreign exporters, obviating the need for an antidumping law to control it. The act has been interpreted to prohibit predatory pricing, and it explicitly states that it applies to combinations and conspiracies "in restraint of trade or commerce among the several States, *or with foreign nations* [emphasis added]."[20] An early Supreme Court decision, however, held that the United States had no jurisdiction under the Sherman Act over acts occurring in other countries.[21] Thus, presumably, if a foreign firm was to come to the United States and sell its exports at predatory prices, it would violate the Sherman Act. If, however, it sold them in its home country at predatory prices to an exporter (or U.S. importer) who then exported them to the United States at a profit, the act presumably would not apply.[22]

Thus, at least implicitly, the question arose as to how to regulate the pricing behavior of foreign firms in the United States. One way was to amend the Sherman Act (and any other subsequent acts relevant to pricing in the United States) to grant the United States jurisdiction for cases involving goods sold in the United States, even if the violation occurred in another country. The same law would then apply to the pricing of both imports and domestically produced goods. Another way was to pass separate laws for pricing of imports. The Congress chose the latter route, and it proved to be a critical decision.

Although the initial laws regulating the pricing of imports were similar to those regulating the pricing of domestically produced goods, the evolutionary paths of the two sets of laws and policies have diverged drastically over time. Antidumping law has fairly consistently evolved in the direction of making it easier to find foreign firms responsible for dumping. Indeed, it is now much easier to find foreign firms to be dumping than it is to find domestic firms guilty of corresponding pricing violations under the antitrust laws.

Section 73 of the Wilson Tariff Act of 1894

The first law relating specifically to monopolistic practices in international trade was Section 73 of the Wilson Tariff Act of 1894, which used language that bore similarity to that of the Sherman Act. It declared:

> That every combination, conspiracy, trust, agreement, or contract is hereby declared to be contrary to public policy, illegal, and void, when the same is made by or between two or more persons or corporations either of whom is engaged in importing any article from any foreign country into the United States, and when such combination, conspiracy, trust, agreement, or contract is intended to operate in restraint of lawful trade, or free competition in lawful trade or commerce, or to increase the market price in any part of the United States. . . .[23]

Violations were criminal offenses subject to fines, imprisonment, or both.

Collusion by domestic importers in predatory pricing schemes of foreign exporters would appear to qualify as a violation of the act. Normally, however, only the exporter--not the importer--is involved with predatory intent, and the exporter's behavior occurs outside the United States.[24] The law was passed before the Supreme Court had ruled acts outside the United States to be beyond the jurisdiction of the Sherman Act, and the logic of that ruling would appear to apply to the Wilson Tariff Act as well.[25] In any case, proving predatory intent is difficult, and cases under the law were rare.

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20. 15 U.S.C. 1, 26 Stat. 209.

21. *American Banana Co. v. United Fruit Co.*, 213 U.S. 347, cited in Viner, *Dumping*, p. 240.

22. More recently the Court has held that the Sherman Act *does* apply to acts committed abroad. For the more recent interpretation, see Joseph P. Griffin, "Extraterritorial Application of U.S. Antitrust Laws Clarified by United States Supreme Court: An Examination of the Jurisdiction Given Courts Under the Sherman Act," *Federal Bar News & Journal*, vol. 40 (October 1993), pp. 564-569, which discusses *Hartford Fire Insurance Company v. California* and the jurisprudence leading up to it.

23. 15 U.S.C. 8, 28 Stat. 570.

24. Indeed, some have argued that the major threat of monopolization of U.S. trade at the time the act was passed came from domestic firms, not from foreign firms, and that predatory pricing of imports was therefore not among the concerns the act was intended to address.

25. Viner, *Dumping*.

Thus, the act provided little protection for domestic producers from low-priced imports.

The Antidumping Act of 1916

Against a backdrop of World War I and accompanying public fears of Germany and its cartels, the Wilson administration--sympathetic to concerns about predatory dumping--recommended further extending the domestic laws against unfair competition (the antitrust laws) to people and firms involved with importing.[26]

The Antidumping Act of 1916 (formally, Sections 800-801 of the Revenue Act of 1916), subsequently passed by the Congress, made it illegal to import goods, or sell imported goods, at prices substantially less than the market value in the principal markets of the country producing the imports, "with the intent of destroying or injuring an industry in the United States, or of preventing the establishment of an industry in the United States, or of restraining or monopolizing any part of trade and commerce in such articles in the United States."[27] Violation of the law was a criminal offense punishable by a fine, imprisonment, or both. Parties injured by a violation could sue for treble damages.

Unlike Section 73 of the Wilson Tariff Act of 1894, this act is clearly directed squarely at something approximating predatory pricing. The approximation is not perfect for several reason. First, whereas the language of the Wilson Tariff Act came about as close to antitrust concepts as is possible, aiming to prevent restraint of trade or free competition, and subsequent higher prices to consumers, the Antidumping Act of 1916 refers to restraint and monopolization of trade but makes no references to higher prices for consumers.

Second, the use of the phrase "or of restraining or monopolizing . . . trade" in the quotation above rather than something such as "in order to restrain or monopolize trade" indicates that low prices with the intent to destroy, injure, or prevent the establishment of an industry in the United States are illegal even when there is no intent to restrain or monopolize trade.

Finally, if the phrase "preventing the establishment of an industry in the United States" is interpreted to mean that foreign firms are prohibited from constantly maintaining low prices so that no domestic firms ever attempt to enter the industry, then the act prohibits "limit pricing"--the practice of pricing at a level sufficiently low to deter the entry of new firms--in addition to predatory pricing. From an economic point of view, limit pricing is less objectionable than predatory pricing, and not objectionable at all when there are no barriers to entry. The low prices cannot end and be replaced by high monopoly prices. As long as there is a threat of a domestic industry's forming, the low prices must continue, thereby providing most or all of the benefits of competition. If, however, that phrase of the act is interpreted to apply merely to low prices by foreign firms that occur only when a new domestic firm appears and begins producing, the phrase indeed prohibits predatory pricing rather than limit pricing.

Despite these deviations from what today would be considered a pure antipredatory pricing act, the Antidumping Act of 1916 was nonetheless a reasonably close approximation to such an act. It still applied only to the importer, however, and not to the foreign exporter. As a result of that limitation and the difficulty of proving the intent described above, the act was seldom used.

Another factor might have contributed to the paucity of cases under Section 73 of the Wilson Tariff Act and under the Antidumping Act of 1916--namely, that the acts were criminal statutes, violations of which were tried in courts with all of the protections that courts provide to defendants. As a result, the laws were strictly construed, and convictions were difficult.[28]

The Antidumping Act of 1916 remains in effect today. It is rarely used because it is easier to get relief from dumped imports under more recent laws.

26. This section of the study draws on discussions in Viner, *Dumping*, pp. 242-245, and House Committee on Ways and Means, *Overview and Compilation of U.S. Trade Statutes*, WMCP:103-1 (1993), p. 63.

27. 15 U.S.C. 72, 39 Stat. 798.

28. See Viner, *Dumping*. Viner also argues that another factor was that no agency other than the Justice Department, which has no special expertise or ability in international trade, was charged with investigating cases. Firms, which had few resources, had to investigate on their own and file civil suits.